



LOCAL GOVERNMENT DIVISION

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Questions or Concerns?

If any entity has questions or concerns regarding budgeting, financial reporting, or compliance with state law or policy, please feel free to call any of the individuals listed above. If we don't have the answer, we can research the question or refer you to the office or individual that can help you! Outside the Salt Lake City area, feel free to use our toll-free telephone number: 1-800-622-1243. You can also e-mail us at the addresses shown above.

February 2005

AUDITOR INDEPENDENCE – AUDITOR ASSISTANCE IN PREPARING FINANCIAL STATEMENTS

As we have visited CPA firms this year, we have found that a topic of frequent discussion is Yellow Book independence standards -- specifically in relation to the amount of assistance the auditor can provide in the preparation of financial statements. This is an issue we have had to consider in our office as well. The new independence standards are now in effect for all financial audits and attestation engagements.

Yellow book standards identify two overarching principles that should be kept in mind when considering whether nonaudit services will impair independence. The overarching principles are first, the auditor should not make management decisions on behalf of the audit client, and second, auditors should not audit their own work.

New independence standards require the auditor to, "...avoid situations that could lead reasonable third parties with knowledge of the relevant facts and circumstances to conclude that the auditor is not able to maintain independence in conducting audits." If the auditor determines that nonaudit services being provided will not impair their independence the auditor must then apply all safeguards outlined in paragraph 3.25 of the Yellow Book.

Yellow Book provides specific guidance relating to the amount of assistance the auditor may provide to the client in preparing the trial balance, draft financial statements and notes. The following has been summarized from Yellow Book paragraph 3.26 and Q&A #46:

- a. An auditor may prepare draft financial statements as long as they are based on management's chart of accounts and trial balance. Any adjusting or closing entries to the trial balance must be ***understood and approved by management.***
- b. An auditor may prepare draft notes as long as they are based upon information determined and approved by management.
- c. A trial balance may be prepared based upon management's chart of accounts and appropriate books and records that balance. Depreciation schedules may be maintained by the auditor as long as management determines the method, rate and salvage value used in the calculation. However, the auditor may not maintain basic accounting records or take responsibility for financial records that they will later audit.
- d. The auditor may not post transactions to the client's financial records. However, the auditor may propose entries that the client ***understands, approves and posts.***

Essentially, the auditor's involvement may only be technical in nature and not involve management

decisions or the maintenance and preparation of underlying financial records that initiate or support a transaction. Also, **management must have sufficient knowledge to evaluate, approve and understand the trial balance, the draft financial statements and the notes in order to take responsibility for them.**

The issue of knowledge and understanding by management requires careful consideration. Auditors need to make an honest evaluation of management's ability to understand and take responsibility for the financial report. If management does not possess this understanding, then arrangements should be made for someone other than the audit firm to prepare the financial statements to preserve independence.

SAFETY OF BANK DEPOSITS

For many years, local governments have had the understanding that local government funds deposited in financial institutions in Utah were safe from default. In fact, many local governments have a sentence in their financial statements that states something like the following: "The State Commissioner of Financial Institutions monitors financial institutions monthly and establishes limits for the deposit of public money at individual financial institutions." This sentence implies that public funds are not at risk if deposited in Utah financial institutions.

However, we have learned that the Department of Financial Institutions monitors the financial institutions only once or twice each year. Therefore, if a financial institution experiences significant financial difficulties between these monitoring periods, the institution could still be holding public funds. Therefore, public funds would be at risk of default.

When the Bank of Ephraim failed last year, there were at least two public entities that lost public funds as a result of this default. Therefore, local governments should not have a note disclosure in their financial statements that implies that deposits in Utah financial institutions are without risk as a result of the monitoring by the Department of Financial Institutions.

CHANGES IN ADDRESSES

The Utah State Auditor's Office sends a lot of mail to local governments in Utah. This mail includes blank forms such as budgets, Census forms, financial statements, newsletters, and review letters. Unfortunately, some of that mail is returned as

undeliverable because we do not have the current address for the local government. Generally, this results from the local government moving its offices, or from a change in a special district board chairperson.



When you prepare change of address forms provided by the U.S. Postal Service, please include us on your list of people and organizations to keep informed of these changes. That will help us get the forms and materials you need. It will also help us avoid withholding funds because we can't get a hold of you to let you know something is missing.

WE'RE HERE TO HELP

Has this happened to you? You finally find yourself with a little spare time and prepare to pursue that hobby you set aside 20 years ago? Suddenly, two of your neighbors knock at your door and ask you to take a position on a special district board. They explain that it is often a thankless job with little or no compensation. However, you feel some sense of responsibility you can't repress and accept the position of public service. As you attend the first meeting you soon wonder, "What have I gotten myself into?"



While working with special districts, we have found many board members who genuinely provide a valuable service to their community. They have exceptional technical knowledge and experience in providing water service, fire protection, mosquito abatement etc., but complying with legal requirements to file reports or hold open meetings is all new to them -- not to mention knowing how to safeguard district funds and assets.

Help is available. Utah law requires that the State Auditor's Office "...prepare instructional material, conduct training programs, and render other services considered necessary to assist districts in implementing the uniform accounting, budgeting and reporting procedures" (UCA 17A-1-445). Our office attempts to satisfy this legal requirement by:

- Providing training for local government officials in nine locations throughout the state each spring (See our advertisement on page 7.)
- Participating in other training assignments as invited
- Preparing a uniform accounting manual
- Maintaining a web site with resources and information
- Being available for questions

Utah law also requires that, “*Each member of a board or governing body of an independent special district, elected or appointed on or after May 3, 1999, should, within one year after taking office, complete training...*” prepared by our office in conjunction with the Utah Association of Special Districts (UCA 17A-1-102).

This requirement may be satisfied by attending the Utah Association of Special Districts (UASD) annual conference or by arranging for Van Christensen from our office and Jan Furner, the Executive Director of the UASD to meet individually with your board.

FINANCIAL REPORTS PREPARED BY CPAS FOR SMALLER ENTITIES

All local governments are required to submit their financial statements to the Utah State Auditor's Office. Governmental entities with total revenues or expenditures greater than or equal to \$350,000 are required to submit financial statements **audited** by a certified public accountant (CPA). Governmental entities with total revenues or expenditures greater than or equal to \$200,000 but less than \$350,000 are required to have their financial statements **reviewed** by a CPA. Governmental entities with total revenues or expenditures greater than or equal to \$100,000 but less than \$200,000 are required to have their financial statements **compiled** by a CPA. Finally if a government has revenues or expenditures less than \$100,000 they are required to submit financial statements **on forms provided by the Utah State Auditor's Office**. In all cases if a governmental entity has at least \$100,000 in revenue or expenditures, the involvement of a CPA is a required part of the financial statement process. The involvement of a CPA is not required if the government has revenue or expenditures less than \$100,000. But what if a local government employs a CPA to help assist fill out the form to be submitted to the Utah State Auditor's Office? Is there anything wrong with having a CPA complete the form

for the local government?

The answer would of course be no. There is nothing wrong with a CPA completing the forms for a local government. However, if a CPA performs this service they should consider Statement on Standards for Accounting and Review Services Standards No. 1 (SSARS No. 1). SSARS No. 1 states that if a CPA submits financial statements to clients or others (i.e. the Utah State Auditor's Office), the CPA is required to at least compile those financial statements. Paragraph 7 of SSARS No. 1 defines submission of financial statements as presenting to a client or others financial statements that the CPA has (1) generated, either manually or through the use of computer software; or (2) modify by materially changing account classification, amounts or disclosures directly on client-prepared financial statements.



What does all this mean? If a CPA prepares financial statements for a local government with revenues or expenditures less than \$100,000 they should consider SSARS No. 1 and issue a compilation report with the completed form. Footnote disclosures and RSI are not required for governmental entities with revenues or expenditures less than \$100,000; therefore the compilation report would follow the guidance relating to compiling of financial statements that omit all disclosures required by GAAP (Generally Accepted Accounting Principals). This is acceptable under SSARS No. 1 as long as the compilation report is modified to alert readers of the financial statements about the omission of the footnote disclosures.

CPAs and local governments should considered the involvement of the CPAs in completing these financial statement forms and determine if it would be appropriate to issue a compilation report to accompany the completed financial statement form submitted to the Utah State Auditor's Office. The compilation report is not a difficult document to prepare and really protects the CPA because the report states that the CPA has not audited or reviewed the financial statements and therefore expresses no opinion or any other form of assurance on them.

If you have any questions you can contact Kent Godfrey at (801) 538-1384 or e-mail him at kgodfrey@utah.gov.

REQUIRED SUPPLEMENTARY INFORMATION (RSI)

As we have reviewed financial statements prepared in accordance with the new reporting model, we have noticed that there is a misunderstanding about the information that is required to be included in the “*Required Supplementary Information*” (RSI) section of the report, and those things that may not be included in that section.

Preparers of financial statement can put whatever information they feel is pertinent and informative in the “Supplementary Information” section of the financial report. However, this is not the case with “*Required Supplementary Information*.” The Governmental Accounting Standards Board (GASB) is very specific as to what must and must not be included in RSI. Only two things can be presented in the RSI section of the report: (1) Budget and actual information for the general fund and major special revenue funds (**and only those funds**); and (2) those entities which have elected the *modified approach* for reporting infrastructure must provide information regarding the condition assessment of infrastructure assets. Of course, the “Management’s Discussion and Analysis” is also considered RSI, but it should be placed in front of the basic financial statements.

The required disclosures related to infrastructure reported using the modified approach include: presenting the results of the three most recently completed condition assessments to demonstrate that infrastructure assets have been maintained at or above the condition level established by the government; and presenting estimates of the amount needed to maintain or preserve infrastructure assets at the level established by the government and actual expenditures for each of the past five reporting periods. The purpose of this schedule is to allow users of the financial statements to make their own assessment of the government’s long-term commitment to maintaining those infrastructure assets.

In addition to the budget information required to be reported in the RSI, reporting of budget and actual information for other governmental funds is encouraged. However, these budget schedules must be placed later in the financial report, in the “Supplementary Information” section of the report.

An alternative to the presentation of budget and actual



information for the general fund and major special revenue funds in RSI is to include this information in the basic financial statements. However, if this information is included in the basic financial statements, the auditor is required to audit the information. On the other hand, when the budget is reported as RSI, the auditor has less responsibility for the information. Also, budget information included in the basic financial statements is still limited to the general fund and major special revenue funds.

SPECIAL DISTRICT INTERNAL CONTROLS

The governing body of each special district is responsible to operate the district in a manner that safeguards public funds and provides for the efficient operation of the district. Laws have been written to assist special districts in achieving this goal; however, simply complying with the law will not adequately safeguard district funds or be a substitute for good judgment. Additional procedures (internal controls) will be necessary to minimize the risk of theft or misuse. We would like to point out three legal requirements that will assist each district in safeguarding district funds.

First, Utah law requires that each district assign three **separate** individuals to function as the district’s chairman, clerk and treasurer. The clerk and treasurer may be members of the board, but these positions may also be filled by other people. Utah law defines the responsibilities of the clerk and treasurer.

Clerk responsibilities:

- Attend meetings and keep a record of the proceedings (UCA 17A-1-434)
- Maintain the financial records (UCA 17A-1-436), and
- Prepare district checks (UCA 17A-1-439).

The clerk should not sign checks. Checks should be prepared after the clerk has determined that the claim was properly authorized, does not over-expend the budget and was approved in advance. The board may designate another person to prepare checks, but this person may not be the treasurer.

Treasurer responsibilities:

- Receive and deposit funds
- Keep an accurate detailed account of all monies received
- Sign district checks, and

- Determine that sufficient funds are available to honor the checks. (UCA 17A-1-437)

Second, the governing body should adopt a purchasing policy and follow it. A policy consistently followed will help ensure that goods are purchased at a competitive price and minimize any real or perceived preferred treatment among vendors. (UCA 17A-1-421)

Third, the governing body should review detailed financial reports and ensure other controls are performed. The law specifies that expenses must be approved and reviewed by the governing body. A proper review of all district receipts and disbursements each month or quarter can be a very effective internal control, especially for small districts with limited staff.

The financial reports to be reviewed should include:

- A detail list of receipts
- A detail list of disbursements
- The cash balance in all bank accounts
- A list of liabilities

In districts where there is little separation of duties or internal controls are otherwise lacking, the governing body should also consider performing other procedures that compensate for the lack of controls. These include:

- A random comparison of receipts, disbursements and cash to the bank statement.
- A random review of invoices supporting disbursements.

The list above is only suggested procedures and may be expanded or reduced as considered necessary by the governing body. The most important thing for a board to consider is where you are at risk and how you can tailor your review to minimize these risks.

Although the laws quoted in this article refer to special districts, the same principles apply for all local governments. Therefore we suggest that all small local governments apply the controls we have outlined above.

ASSESSING AND COLLECTING

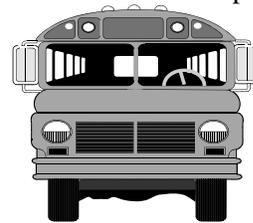
The State Auditor’s Office administers a property tax valuation agency fund which receives revenue from a multi-county property tax levy. The funds generated by this levy may be used by counties for, “establishing and maintaining accurate property valuations and uniform assessment levels ... and improving the efficiency of the property tax system.” (UCA 59-2-906.2(5))

Because the money collected in this fund may only be used for specific purposes, each county must evaluate which departments perform functions related to the assessing and collecting of property taxes. Some county departments, such as the assessor’s office, may be able to allocate all expenditures to this levy while other departments, such as the clerk/auditor’s office, may only be able to allocate a portion of their expenditures.

Revenues related to property taxes received by a department must also be considered. For example, fees charged and collected by the recorder’s office must reduce expenditures allocated to the levy. We encourage all counties to analyze all revenues related to assessing and collecting property taxes to ensure they are netted against related expenditures. Counties should also ensure that funds received from the assessing and collecting levies are used only for activities related to assessing and collecting property taxes. Independent auditors should also ensure that related revenues are netted against assessing and collecting expenditures as part of their State Legal Compliance testwork.

ASSET CAPITALIZATION POLICIES

The Governmental Accounting Standards Board issued Statement No. 34, which affects the financial reporting of all local governments. This statement has resulted in significant changes in the way that financial information is reported. This has forced many governments to account for and capture information they have not had to consider in the past.



One new component of this statement which affects nearly every local government is the capitalization of assets. In order to meet this new requirement, a local government must first establish a capital asset policy. It is important that this policy be formally adopted by the governing body and not just implemented by the person preparing the financial statements.

A capital asset policy should include:

- the threshold above which assets will be capitalized
- the useful life of each class of asset, and
- the method of depreciation

The following is a sample capital asset policy:

Capital assets include property, buildings and equipment. Capital assets are defined by the District as assets with an initial, individual cost of more than \$1,000 and an estimated useful life in excess of two years. Such assets are recorded at historical cost. Donated capital assets are recorded at estimated fair value at the date of donation.

The costs of normal maintenance and repairs that do not add to the capacity of the asset or materially extend assets lives are not capitalized. Property, plant, and equipment are depreciated using the straight line method over the following estimated useful lives:

<u>Assets</u>	<u>Lives</u>
Buildings	30-40 years
Improvements other than Buildings	20 years
Equipment	5-10 years
Vehicles	5 years
Office equipment	5-10 years
Computer equipment	3 years

(This is an example of a capital asset policy and is in no way a recommendation from the State Auditor’s Office of the thresholds, lives, etc., that should be used by local governments in Utah.)

**TRANSFERS :
WHAT THEY ARE AND WHAT
THEY ARE NOT**

There seems to be some confusion regarding transfers, contributions, and interfund transactions as they apply to budgets. A transfer refers to the movement of money from one fund to another for the purpose of using or accumulating those funds in another fund. It is not to be used for payment for goods and services provided between funds. These transactions should be recognized as revenue or expense/expenditure in the appropriate section of the budget.

An example of a transfer would be to move money from the general fund to a capital projects fund in order

to accumulate funds to purchase or build a specific project authorized by the city council.

A transfer is NOT for the purpose of reimbursing a fund for services or supplies rendered to another fund. For example, administrative or overhead services provided by the general fund to the water enterprise fund should not be reimbursed by means of a transfer from the enterprise fund to the general fund. Instead it should be shown as an expenditure of the enterprise fund and revenue of the general fund. Likewise, tax revenue or fee in lieu of taxes paid by an enterprise fund should be shown as an expense of the enterprise fund and as revenue of the general fund for those fees paid.

The budget line item entitled “contributions” will be eliminated from the budget form in the future. In the past it was intended to be used for residual equity transfers. But, in practice they were seldom used for this and instead tended to be an item of confusion more than anything else. We may introduce a category called “contributions and donations from outside sources” since municipalities often receive a variety of donations from various sources.

Finally, any discussion about transfers is not complete without emphasizing that transfers must equal, that is, transfers-in must equal transfers-out. If you transfer money from the general fund to an enterprise fund, it should appear as a transfer-in in the enterprise fund, not miscellaneous revenue.

**MAXIMUM ALLOWABLE FUND
BALANCE IN THE GENERAL
FUND FOR CITIES**

The general fund, in all local governments, is limited on the amount of money that can be carried over from one year to the next. The allowable amount varies from one type of entity to another. However for cities, Utah Code Section 10-6-116(2) specifies that the fund balance “shall not exceed 18% (75% for towns) of the total estimated revenue of the General Fund.” There has been some confusion as to what is meant by this. The State Auditor’s Office has defined total estimated revenue of the general fund to mean the total revenue expected to be received during the next budget year net of transfers-in from other funds and beginning fund balance to be appropriated, since this money was received in previous periods and should not be considered actual revenue of the current year.

LOCAL GOVERNMENT ANNUAL REGIONAL TRAINING SESSIONS – 2005

The Local Government Division of the Utah State Auditor's Office sponsors annual spring training for local government . The Regional Spring Training Seminars are held at nine locations throughout the State. The seminars are intended for municipalities, counties, special districts, school districts and private non-profits working with governments. **We invite mayors, council members, clerks, recorders, treasurers, board members commissioners, and independent auditors who work with local governments to attend.** This year, as in the past, we will be discussing current financial issues that affect budgeting and accounting officials from local governments. In addition, with GASB Statement No. 34 in place, we will spend some time explaining the new reporting model and what it means to non-accountants. This would be **perfect for mayors, council members, commissioners and board members** who rely on the financial statements but do not have a thorough understanding of the new reporting model. Fraud has become such an issue lately that we are also offering an update on our fraud training that every local government official should hear. We will have an update on the effects of the 2005 legislative session on local governmental entities, a presentation on current issues from the Utah State Tax Commission and information on other critical issues. We will also hold a budget training session for new budget officers. The following is a list of times and locations.

Choose the location and time most convenient for you. **(Note we have added Moab for 2005.)** We hope to see you there!!!

SOUTH OGDEN

Tuesday March 29, 2005
So. Ogden City Offices
560 39th St.
9 am – 1 p.m.

9 a.m. – 1 p.m.

SALT LAKE CITY

Wednesday April 13, 2005
State Office Building – Auditorium
At the State Capitol
1 p.m. – 5 p.m.

St. GEORGE

Thursday March 31, 2005
Co. Bldg. Commission Chambers
197 E. Tabernacle (Parking in the rear)
1 pm – 5 pm

MOAB

Tuesday April 26, 2005
Moab Arts & Recreation Center (The MARC)
100 East 100 North
9 a.m. – 1 p.m.

RICHFIELD

Friday April 1, 2005
Comm. Chambers
250 North Main
9 am – 1 p.m

PRICE

Wednesday April 27, 2005
2nd Fl Room 207
185 E. Main
9 a.m. – 1 p.m.

OREM

Monday April 11, 2005
Room 102 - Council Chambers
56 North State Street
9 a.m. – 1 p.m.

VERNAL

Thursday April 28, 2005
South Conference Room
147 E. Main
9 a.m. – 1 p.m.

LOGAN

Tuesday April 12, 2005
Bridgerland Applied Tech College
Room 171E – Enter South Doors
1301 N. 600 W.

ANNOUNCEMENT FOR ALL CPAs

The State Auditor's Office will once again be holding its *"annual"* training for auditors of local governments. So set aside this important date. Please note the starting time!

May 5, 2005
12:00 pm to 4:00 pm
Larry Miller Campus of
Salt Lake Community College



Watch your mail for registration information.

See You There!